**Solution Manual**

to accompany

**Accounting: Business Reporting for Decision Making 4e**

Jacqueline Birt, Keryn Chalmers, Suzanne Byrne, Albie Brooks & Judy Oliver

Prepared by

Jacqueline Birt



John Wiley & Sons Australia, Ltd 2012

**Chapter 1: Introduction to accounting**

**Comprehension Questions**

**1.1 What is a business transaction and how does it relate to the accounting process? Illustrate the concept of a business transaction with five examples relating to a mobile phone distributor.**

A business transaction can be defined as external exchanges of resources between the entity and another entity or individual that affects the assets, liabilities and owners’ equity items in an entity. The accounting process is the identifying, measuring and communicating of economic information about an entity to a variety of users for decision-making purposes. The first component of the process is the identification of business transactions which are then measured and communicated to the different users of financial reports.

Business transactions for a mobile phone distributor include the following:

1. The contribution of capital by the owner to commence the business. This transaction would increase cash (asset) and increase capital (equity).

2. The purchase of inventory (mobile phones) on credit. This transaction would increase inventory (asset) and increase creditor (liability).

3. The payment of office rent. This transaction would decrease cash (asset) and decrease profit (equity).

4. The purchase of office equipment for cash. This transaction would increase office equipment (asset) and decrease cash (asset).

5. Withdrawal of business funds by owner. This transaction would decrease cash (asset) and increase drawings/decrease capital (equity).

**1.2 Differentiate between financial and management accounting. Give an example of how management accounting reports would be incorporated into financial accounting reports.**

In differentiating between financial accounting and management accounting it is important to consider the users of financial information — both internal and external users. Financial accountants prepare and report information for external users (for example prospective investors or the tax office) and as such are subjected to regulation from GAAP, the Corporations Act and in some cases the ASX through their **Listing Rules.** Management accountants are concerned with the effective use of an entity’s resources, and in so doing assist the manager/s (i.e. internal users) of the entity in achieving their goal of enhancing customer and shareholder value. Therefore the management reports generated need to be up to date to be effective. Regulation in management accounting is much less formal and in some areas rules are basically non-existent. Ultimately there will be interaction between the financing accounting and management accounting areas. The information provided by management accountants will provide information for internal users that will be reflected in the financial reports used by the external users. See Table 1.3, page 10, for a detailed list of the differences between financial and management accounting.

**1.3 Describe how accounting information helps shareholders and lenders to make decisions concerning the operations and performance of the entity.**

As mentioned in the solution to question 1.2, users of accounting information (both internal and external) require accounting information to assist them in the decision making process. Internal users (being the management of the entity) require such information to assist them in budgeting, competitive price setting, profit forecasting, investment decisions, employee information, correct sales mix etc. External users such as investors, employees, banks, suppliers, government agencies (e.g. ATO) all have their own specific information needs. A potential investor will require past profits and future profit projections, as well as future growth prospects, to determine if the entity is a good investment proposition or not. A bank will be seeking details of the level of risk it is exposing itself to by lending money to the entity plus the prospects of the entity repaying its’ debt. Employees may use financial reports to seek out job security, possibilities of the entity expanding, promotion prospects etc.

**1.4 What is corporate governance? What are the areas of corporate governance discussed in the Qantas Group annual report?**

Corporate governance in an entity specifies the distribution of rights and responsibilities among different participants in the entity. The main participants are the board, managers and shareholders. Examples of corporate governance mechanisms include: the rights of shareholders, the role and responsibilities of the board, and the disclosure and transparency of the entity.

In the Qantas Group annual report, the Corporate Governance Statement discusses the following:

* Independence of the board directors
* The membership of the Nominations Committee
* The appointment and re-election of directors
* Diversity of women on the board
* The induction and continuing development of directors
* The review of board performance
* Ethical and responsible decision-making by the board
* Qantas' share trading policy
* Whistle blower Policy
* The integrity of financial reporting
* Risk management
* Safety, Health, Environment & Security Committee
* Group Audit and Risk
* Remuneration Committee
* Review of Executive Management Performance

**1.5 Refer to the reality check ‘A Glimpse into the future of the accounting profession’. What are the major factors influencing the nature of accounting work?**

The major factors influencing accounting work include the following:

* Technological change and globalisation – lower value transactional work is expected to be fully automated and off shored to lower-cost markets. Therefore, tasks that involve human ingenuity, creativity and innovation will be more in demand.
* Retirement of baby boomers − from 2011 onwards, people coming into accounting will be from a different generation and also have different values. There will possibly be less career accountants and more mobile workers who have expertise globally and across different entities.
* Change in the structure of accounting firms – more consolidations in accounting firms and the importance of mid-tier firms who are likely to experience restructuring in terms of services offered to clients.

**1.6 List six stakeholders of accounting information. Describe the information requirements for each one; for example, lenders would need information regarding the business's ability to repay debt and service a loan.**

**STAKEHOLDERS: INFORMATION NEEDS:**

**Internal Stakeholders:**

Managers require information to determine make or buy decisions or whether to expand or close down or whether to change banks.

**External Stakeholders:**

Investor seek information on capital growth prospects and future dividend payments.

Lenders need information on the ability of the entity to repay its loans.

Suppliers want to know can the entity pay for its supply purchasers.

Consumers are interested in the life expectancy of the entity and the entity’s ability to provide appropriate goods and services.

Government agencies for example, ATO — require information to determine the amount of tax liability of the entity.

Regulatory bodies for example, ASX and ASIC need to know whether the entity is following the ASX listing rules and the rules and regulations of the Corporations Act.

# 1.7 One of the limitations of accounting information is the historical nature of the financial statements. Provide an example of an asset from the balance sheet of JB Hi-Fi Ltd where the asset's historical cost may not reflect its current value.

One example of an asset where the reported historical cost may not reflect its current value is plant and equipment. The notes to the financial statements state that plant and equipment are stated at cost less accumulated depreciation and impairment (if any). This amount may not reflect its current value. Impairment tests allow for the asset to be written down if its carrying amount exceeds its recoverable amount. However, there is no provision for any revaluation upwards.

**1.8 Sarah Kee is considering purchasing a sushi bar in the inner Canberra suburb of Dickson. Discuss three important issues that Sarah would need to talk over with her accountant before she purchases the sushi bar.**

Sarah should seek the advice of her accountant regarding the following:

1. Evaluate the purchase — from the accountant’s experience (or with assistance from his/her professional association) advice can be obtained on whether the purchase is a good buy or not e.g. through comparisons of similar recent sales; analysing past financial reports.

2. Prepare budget forecasts e.g. on sales — i.e. target sales of food necessary to make the purchase worthwhile or to compare whether it is better financially to remain in your present job and make passive investments with your capital. This will enable a prospective buyer to evaluate if such sales are feasible by her.

3. Explain the personal qualities required in owning such a business e.g. long hours; tedious work; customer relationships; impact on family life etc.

**1.9 How can a professional association membership help a graduate accountant in their job?**

Each of the three professional associations in Australia provides a range of different services for the new accounting graduate. Services include:

* further education through the CPA, CA and MIPA programs
* technical assistance on accounting standards and the Framework
* support for graduates through the resources on the web, seminars and continuing education programs
* guidance in relation to the code of ethics for professional accountants

**1.10 Give an example of the role accounting information plays in the investment planning for a retired golf professional and for the senior management of a large company such as the Qantas Group.**

Accounting provides us with a language to help understand the decision making process associated with investment planning. A retired golf pro would use accounting to help keep track of his/her superannuation funds. Senior management of a large company such as Qantas would use accounting for the allocation of scarce resources in decisions such as; purchasing property, plant and equipment, whether to lease or buy an aircraft, evaluating budget performance and against actual performance, deciding which whether to expand the fleet of aircraft, determining dividend payouts for ordinary shareholders and deciding whether it is cost effective to upgrade the existing Qantas Club facilities.

**1.11 What are some of the opportunities and threats for the accounting profession resulting from the large number of corporate collapses in the early 2000s?**

The large number of corporate collapses in the early 2000s and throughout the last decade provides many opportunities for the accounting profession. Such as:

* employment in areas such as forensic accounting, insolvency, taxation, auditing
* demand generally for accounting and audit services
* demand for accountants with experience working with global accounting standards
* job opportunities overseas with the Big 4 accounting firms and multinational entities

**Threats**

* Accounting professions’ work under more scrutiny
* There has been an increase in litigation against accountants and auditors
* The demise of some accounting firms e.g. Arthur Andersen

**1.12 Compare and contrast the roles of the Australian Securities and Investments Commission (ASIC), the Australian Competition and Consumer Commission (ACCC) and the Australian Securities Exchange (ASX).**

The ASIC, the ACCC and the ASX are all sources of regulation for business entities. The ASIC’s role is to act at the ‘corporate watchdog’ and in doing so uphold the law and make information about entities available to the public. ACCC’s main role is to protect the consumer from certain actions of business entities including anticompetitive behaviour and product safety. The ASX regulates listed entities on the stock exchange through its Business Rules and Listing Rules which are in addition to the regulations in the Corporations Act.

**1.13 What is the difference between the *Conceptual Framework's* fundamental qualitative characteristics of relevance and faithful representation? Provide an illustration of a situation in an entity's financial report when one of the characteristics would be traded off against each other.**

Relevance implies that the information should have predictive and confirmatory value for users in making and evaluating economic decisions. Faithful representation implies that the information fully represent the phenomena it purports to represent. This means that the financial information will be complete, neutral and free from error.

An illustration depicting a trade-off between relevance and faithful representation would be the accounting practice of estimating doubtful debts expense. The process of estimating doubtful debts expense is relevant to the decision making process. It is necessary to determine an estimate so that revenues for the period can be appropriately matched with the expenses for the period. However, if you estimate doubtful debts expense the estimate that you use does not faithfully represent the actual amount of bad debts expense i.e. is unlikely to be an amount free from error. However, the process of estimating the expense is useful to the decision maker.

**1.14 Explain how CPA Australia and the Institute of Chartered Accountants in Australia would assist in standard setting.**

CPA Australian and the ICAA provide feedback on exposure drafts and forward any comments on to the AASB. They also inform their members of any accounting standard developments through newsletters and by conducting Continuous Professional Education (CPE) sessions. The professional bodies’ websites provide on-going advice and information on a range of topics including the adoption of IFRS, the *Framework* and compliance issues.

**1.15 Describe the major purpose of the ASX, and give examples of three of the Listing Rules. You will need to go to the ASX website at www.asx.com.au.**

The major purpose of the ASX is to provide an orderly and fair market in listed companies’ shares and securities. It also regulates companies through its Business and Listing Rules. The ASX Listing Rules govern the procedures and behaviour of all ASX listed companies and listed trusts.

Three examples of Listing Rules are:

Chapter 5: Additional reporting on mining and exploration activities. This Listing Rule concerns the mining and exploration industry sector and the additional disclosures they must make such as details of the mining production and development activities and details of exploration activities.

Chapter 17: Trading halts, suspension and removal. This Listing Rule explains the information that an entity must provide to the ASX if there is going to be a trading halt. Such as reasons for the halt and how long it will last.

Chapter 14: Meetings. This Listing Rule outlines the ASX requirements for meetings such as general meetings and directors’ meetings.

**1.16 What is the impact of the qualitative characteristic of 'materiality' on the preparation of the financial statements?**

The qualitative characteristic of 'materiality' is another important assumption in accounting. According to the accounting and legal professions, material information is that which affects the decisions made by users of the financial reports in which the information is disclosed. Determining a material item should include a quantitative and qualitative evaluation of that item. The factors that need to be considered are type of entity, size of entity and the industry that the entity is operating in. Significant professional judgment is necessary. The impact of this characteristic on the preparation of financial statements is that information is only disclosed if it affects the decisions made by users of financial reports. Therefore, in financial reports amounts are rounded up to the nearest thousand or ten thousand. Individual assets are not listed in the Balance Sheet - the notes to the financial reports would provide a description of assets under each class of asset on the Balance Sheet.

**1.17 The reality check 'Letters to SEC show support of global standards, according to Official' on pp. 11-12 looks at issues associated with the United States convergence with IFRSs. What are the advantages and disadvantages of globalised financial reporting? What are the disadvantages of the United States implementing IFRSs?**

The advantages of globalised financial reporting include; a common accounting language, greater consistency in financial reporting, cost savings in producing one set of reports and greater transparency in financial reports.

The disadvantages of globalised financial reporting are the costs associated with all applicable entities adopting global standards. There are two types of costs: (1) information and processing costs and (2) potential proprietary costs. For some entities there will be additional costs associated with providing information complying with global standards and some entities may have to disclose more information to comply with the standards and this potentially could involve the release of commercially sensitive information to the market (e.g. additional disclosures on business and geographic segments of operations).

When the US adopts IFRSs, then the standards will be ‘global’ standards. This will reduce costs associated with entities who currently have to prepare more than one set of financial reports to comply with US GAAP and assist users in interpreting financial statements between entities listed in the US and other countries overseas.

**1.18 Explain the relationship between the Financial Reporting Council (FRC), the Australian Accounting Standards Board (AASB) and the International Standards Board (IASB).**

The FRC is a statutory body that is responsible for overseeing the AASB. It is made up of key stakeholders from the business community, the professional accounting bodies, governments and regulatory agencies. The AASB is responsible for the development of accounting standards to be followed when preparing GPFRs (General Purpose Financial Reports). The standards have the force of law under the Corporations Act. Disclosing entities, public companies and large corporations must apply the standards when preparing their financial reports. Since 2005, the AASB has released AIFRS – Australian Equivalents of International Financial Reporting Standards issued by the IASB.

**1.19 The main role of the Financial Reporting Council (FRC) is to oversee the:**

**a. Australian Accounting Standards Board (AASB).**

**b. Australian Securities and Investment Commission (ASIC).**

**c. two professional accounting bodies in Australia.**

**d. the Australian Securities Exchange (ASX).**

a. Australian Accounting Standards Board (AASB)

**1.20 Australian Accounting Standards are issued by the:**

**a. Australian Taxation Office. (ATO)**

**b. Corporate Affairs Commission. (IPA)**

**c. Australian Accounting Standards Board. (AASB)**

**d. Institute of Chartered Accountants in Australia. (ICAA)**

c. Australian Accounting Standards Board (AASB)

**1.21 The accounting process includes**

**a. identifying, measuring, communicating.**

**b. identifying and reporting only.**

**c. identifying and classifying only.**

**d. identification and decision making only.**

a. The process of identifying, measuring and communicating economic information about an entity to a variety of users for decision-making purposes.

**1.22 The main purpose of notes to financial statements is to:**

**a. provide extra information on an entity.**

**b. provide a cash flow statement for the entity.**

**c. provide an auditor’s report.**

**d. provide a cost/benefit analysis for the entity.**

a. The main purpose of notes to financial statements is to provide extra information on an entity.

Application and Analysis Exercises

**1.23 Provide an example of the different types of activities that would be performed by a management and financial accountant for the Qantas Group.**

The management accountant would perform activities such as capital budgeting for future aircraft purchases, preparation of budgets and cost-volume-profit analysis for a new business venture e.g. takeover of competitor airline to increase revenue.

**1.24 What is the difference between an income statement and a statement of comprehensive income? Explain with reference to JB Hi-Fi Ltd.**

A traditional income statement would list the revenue less expenses for JB Hi-Fi Ltd. Expenses would include; sales and marketing, occupancy, administration, other, finance costs and income tax expense.

A statement of comprehensive income would include the profit for the year, changes in the fair value of cash flow hedges and exchange differences on translation of foreign operations.

**1.25 Growth areas for accountants in the future include sustainability reporting and more specifically carbon accounting. What are the costs and benefits for entities in reporting their carbon ‘greenhouse gas' emissions?**

A firm's sustainability report includes a section on environmental issues. The JB Hi-Fi Ltd report states the following:

"In 2011 JB Hi-Fi for the third year responded to the Carbon Disclosure Project (CDP). The CDP is a not for profit organisation that collates and reports company environmental actions to external users such as investors and other corporations. JB Hi-Fi has systems in place to ensure we are reporting and monitoring energy consumption and greenhouse gas emissions. In addition JB Hi-Fi seeks to identify opportunities and implement solutions to reduce energy consumption and greenhouse gas emissions whilst maintaining our low cost of doing business."

The benefits of reporting the above are that JB Hi-Fi is sending a very positive message to its various stakeholders. Its systems to report and monitor carbon and also to reduce energy consumption would be met favourably by stakeholders such as investors, consumers, employees and the general public.

The costs of providing the information and the subsequent report on carbon emissions levels are two-fold. First, the information/resource costs associated with measuring carbon emissions and other related information and second, the potential negative feedback from stakeholders on the extent of the carbon emissions. For example if JB Hi-Fi increases carbon emissions over several reporting periods this could be perceived by stakeholders as a negative signal relating to the company's efforts to reduce emissions.

**1.26 Carbon accounting is a very important and huge growth area of accounting. Discuss the different stakeholders (and their information needs) that would be interested in the carbon accounting report.**

|  |  |  |
| --- | --- | --- |
|  | **Stakeholder** | **Information needs** |
| 1. | Management | Levels of carbon emissions can provide targets to improve  environmental performance, can also be tied to executive  remuneration. Significant costs can lead to increased costs  and reduced sales. |
| 2. | Investors | Assist in investment decision making. Research has found  that firms with higher disclosures of CSR and carbon can  lead to improved financial performance and share price. |
| 3. | General public | Interested in comparing companies to determine if they  are managing their carbon risks and reducing emissions. |

**1.27 The AASB's role has changed since the introduction of IFRS in 2005. Most of the Australian accounting standards mandated in Australia are Australian equivalents to IFRSs. What are the advantages of adoption of IFRSs from the AASB's perspective?**

The Australian standard setter i.e. the AASB has changed its role since the adoption of IFRS in 2005. It is not solely making accounting standards for use by Australian reporting entities, much of that role is now undertaken by the IASB in its development of IFRS. IFRS adoption means that the AASB can now contribute to the development of global financial reporting standards. Most recently, the AASB provided export support on the IASB's discussion paper on 'extractive activities'.

**1.28 The sustainability report is a recent disclosure by some Australian companies. What do you think are the advantages and disadvantages to the company of providing such disclosures? How can the information disclosure benefit a company from a high polluting industry?**

A company's sustainability report includes sections such as safety and health, customer, people, environmental statement, financial and community. Such disclosures provide a positive signal about the company to various stakeholders such as consumers, investors, general public, employees and suppliers (see 1.26 table).

Information disclosure about environmental issues can benefit a company from a high polluting industry as these types of industry are closely scrutinised by various stakeholders and the media. If the company discloses negative information about environmental performance e.g. the level of carbon emissions higher than expected, then this information could shock the general public, the media and markets into making changes externally (Stephan, 2002). If the company discloses positive information about environmental performance then this can be seen as a signal that the company is doing the right thing and in the long run could increase profits and the market capitalisation of the company.

**1.29 The historical cost nature of the annual report is seen as being a limitation of financial accounting information. What do you think are the advantages and disadvantages of using historical costs? What are the implications of the usage of historical costs for lenders and prospective investors?**

Historical cost accounting requires that items in the annual report such as assets are reported at their original cost. This has various advantages. Historical costs are seen as being reliable figures where there has been evidence of the actual price e.g. invoice, receipt. Other methods of valuation are not always reliable, as management can use their discretion (sometimes opportunistically) to arrive at the value which could be detrimental to the firm. Disadvantages of using historical costs are that they may not be relevant and for that reason may not reflect the real value of the firm. Lenders most likely would be interested in the historical cost of Balance Sheet items and if there are any impairment losses. For prospective investors while historical costs are probably useful for assets such as vehicles and equipment, for assets such as land it would be more beneficial to know the market value. For assets such as inventory, the net realisable value would be worthwhile knowing (expected selling price less any costs of selling).

**Synthesis and Analysis Problems**

**1.30 Australian Accounting Standards**

**There are at least 50 Australian Accounting Standards. Go to the AASB website at** [**www.aasb.gov.au**](http://www.aasb.gov.au) **and choose one. (Hint: Go to ‘Quick Links’ and select ‘Table of Standards’.) State the operative date of the standard, and its scope and purpose. What changes (if any) have occurred to this standard since the adoption of IFRSs in 2005?**

**Instructor’s note:**

The AASB website contains information on current standards. Each of the standards are available in word or Pdf format. Additional notes are available on certain standards and information such as issue date and operative date is also provided.

1.31 **AASB and input to the IASB**

**The AASB, as part of its work program, offers comment on documents such as proposed agenda decisions, exposure drafts, draft exposure drafts, invitations to comment and discussion papers. Go to the ‘Work program’ page of the AASB website at www.aasb.com.au and choose 'Summary AASB work program'. One of the topics listed relates to the IASB financial crisis projects. Why do you think it is necessary for the AASB to actively participate in the development of accounting standards relating to the financial crisis?**

The financial crisis impacted on companies and stakeholders globally and had both short-term and long-term effects. It is necessary for the AASB to actively participate in the development of the IASB financial crisis project as Australia has adopted IFRSs and can provide expert advice on the matter and influence the future accounting standards evolving from this project. To ensure that the best interests of Australian entities and their stakeholders are taken into consideration the AASB must continue to influence standard setting internationally by participating in research projects such as the financial instrument project, issuing exposure drafts simultaneously to the IASB, and having representation on IASB project teams.

**1.32 Professional institutions**

**CPA Australia, the ICAA and the Institute of Public Accountants (IPA) have designated areas on their websites for technical resources and updates. Go to each of the respective bodies’ websites (www.cpaaustralia.com.au, www.charteredaccountants.com.au and www.publicaccountants.org.au) and summarise the resources provided.**

CPA Australia, ICAA and IPA have various resources to assist members with adopting AIFRS. These resources include:

* Articles on adopting AIFRS
* Draft submissions from the professional associations on IASB’s exposure drafts
* Latest news in relation to AIFRS
* AIFRS compared to IFRS and the old GAAP
* Interpretations and guidance
* AIFRS fact sheets
* IFRS implementation kit for the public and private sectors

**1.33 Legal implications of standards**

**What is the difference between an accounting standard and the *Conceptual* *Framework* in terms of authority of law?**

The Australian accounting standards have the force of law under the Corporations Act for disclosing entities. The *Framework* contains statements to assist in the preparation and presentation of financial reports however it does not have the force of law and therefore its role is more to substantiate the accounting standards and provide further guidance on the application of the standards.

**1.34 International convergence**

**It is argued that the convergence of our accounting standards with international standards will bring great benefits to the Australian economy. How do you think our international trading position will be enhanced through such convergence?**

During the past couple of decades there has been much debate surrounding the need to adopt a set of international reporting standards. Supporters of international accounting standards argue that the accounting standards of a number of countries are too summarised, lack appropriate guidelines and contain vague, ambiguous statements. There have also been many differences in the requirements of different jurisdictions, and this has led to a lack of comparable information being disclosed between different countries.

The adoption of international standards should have a number of benefits for the Australia economy including:

* A global language will be achieved for financial reporting. IFRS are now developed in consultation with countries around the world.
* Business, investors and other stakeholders will more effectively communicate, understand and engage.
* With an increase in understanding of global financial reporting this should lead to more informed decision making by entities and their stakeholders.

**1.35 Disciplinary action**

**Every time there is a spate of corporate collapses, the accounting profession has been closely scrutinised, and many members of the professional bodies have appeared before disciplinary hearings. These disciplinary hearings are summarised on the professional bodies respective websites (e.g. www.charteredaccountants.com.au). What types of action might cause members of the profession to go before a disciplinary hearing of their professional body?**

Instructor’s notes: both the ICAA and CPA websites contain useful information in relation to disciplinary hearings.

The types of actions include the following:

* Failure to observe a proper standard of professional care, skill or competence
* Failure to respond to a client’s correspondence on personal and business tax returns
* Continuing practising as an accountant in a business that was in the process of liquidation.
* Failure to return client monies held in trust accounts
* Failure to comply with the code of conduct.

**1.36 Joint conceptual framework project**

**Go to the IASB website at www.iasb.org and comment on the benefits of having a ‘joint conceptual framework project’. What is the current status of the project and what are the benefits of such a project?**

The IASB and the US FASB are currently in the middle of developing a joint conceptual framework of accounting. This *Framework* would be ‘both complete and internally consistent’ and therefore would improve on the two respective *Framework*s of the IASB and the FASB. It is hoped that a joint *Framework* would assist in the development of future accounting standards by having a basis of consistent principles that would lead to financial reporting that would assist entities and their stakeholders in making better more informed decisions.

The main changes are:

* Use the term faithful representation to refer to the characteristic that had been labeled reliability in the existing framework.
* Classify relevance and faithful representation as fundamental characteristics.
* Clarify that the components of faithful representation (neutrality, completeness, and freedom from error) are not absolutes. For example, the phrase freedom from error is not intended to imply that financial statements must be 100 percent accurate.
* Classify verifiability, comparability, timeliness, and understandability as enhancing characteristics.
* Describe materiality and cost as constraints on financial reporting.

**1.37 Regulatory responsibility**

**What might happen if the accounting profession did not have to follow accounting standards when preparing financial statements?**

Instructor’s note: there are several acceptable responses to this problem as there are several outcomes that could arise if the accounting profession did not have to follow accounting standards. Responses to this problem could include:

* too much detail in the financial reports provided by some entities
* not enough detail in the financial reports provided by entities
* confusion in interpreting the financial reports
* confusion in preparing the financial reports
* misleading financial reports
* lack of uniformity in financial reporting
* inability for users to compare financial reports
* difficulty in the analysis and reporting phase of financial reporting.

**1.38 Corporate governance**

**The JB Hi-Fi Ltd governance statement in its annual report discusses the code of conduct of the company. What are the key elements of the code?**

The key elements of the code are:

* respecting every employee's dignity and rights
* providing a working environment that is safe
* recognise the work of each employee
* obey the law
* reinforce the company's commitment to the highest standards in business and professional ethics.

**1.39 Sustainability reporting**

**The Qantas Group includes a sustainability report in its annual report. What key performance indicators are included in this report? Explain the different stakeholders that would be interested in this information.**

The key performance indicators included in this report are:

1. safety and health

2. customer

3. people

4. environment

5. financial

6. community

The employees of the company would be interested in the safety and health measures undertaken by Qantas Group and the statistics such a absenteeism and injury frequency rate. Customers would be interested in the percentage of on-time departures, on-time arrivals and cancellations. Future employees may be interested in the gender diversity of the organisation such as number of woman directors on the board of directors. Future employees may also be interested in the age and cultural diversity of the workplace. Prospective investors may be interested in the aviation fuel and carbon emissions statistics and the airlines investment in fuel efficient aircraft.

**Case Studies**

1.40

**Go to the ASX website (www.asx.com.au).**

**a. Click on ‘Education”, then ‘What are shares?’ Complete the course 'Risks and benefits of shares'. Summarise the benefits of owning shares in a company.**

**b. Next, click on ‘Prices, Research & Announcements’, then ‘Market statistics’. Under the heading ‘Most traded shares’ click on the value of the top 20 shares. What are the current top 20 shares by value?**

**c. Again under ‘Market statistics’,, under the heading ‘Historical market statistics’ click on ‘number of listed entities’. What is the current number of listed entities on the ASX and what is the percentage increase since 2002?**

a. Benefits include:

* **Potential to outperform other investments over the long-term**
* **Capital growth and Dividends**
* Tax benefits
* Diversification
* **Ease of buying and selling**
* Control over your financial future

b. 30 April 2012 - Top 20 shares by value

|  |
| --- |
| BHP BLT |
| NAT. BANK |
| CWLTH BANK |
| [TELSTRA](http://www.asx.com.au/asx/research/companyInfo.do?by=asxCode&allinfo=&asxCode=TLS) |
| WESTPAC |
| ANZ BANK |
| RIO TINTO |
| [CSL](http://www.asx.com.au/asx/research/companyInfo.do?by=asxCode&allinfo=&asxCode=NAB) |
| NEWCREST |
| FORTESCUE |
| WESTFIELDG |
| WOODSIDE |
| WESFARMER |
| WOOLWORTHS |
| ORIGIN ENE |
| WESTFTRUST |
| MACQ GROUP |
| BRAMB LTD |
| ILUKA RES |
| ATLAS IRON |

c. Number listed on the ASX at 30 April 2012 is 2223. There is a 48% increase in number of listed entities since the same time in 2002.

1.41

**After successfully running her small private recruitment agency for a number of years, Jessica feels it is now time to expand. Her friends in business have told her to ‘get big or get out’. One of the options she is investigating is whether or not to list on the ASX. She has heard that the ASX has its own regulation in the form of Listing Rules.**

**a. Go to www.asx.com.au and conduct a search under ‘Listing Rules’.**

**b. Give examples of some of the Listing Rules that Jessica must abide by if she decides to list her recruitment agency on the ASX.**

b.

|  |  |
| --- | --- |
| 1 | [Admission](http://www.asx.com.au/ListingRules/chapters/Chapter01.pdf) |
| 2 | [Quotation](http://www.asx.com.au/ListingRules/chapters/Chapter02.pdf) |
| 3 | [Continuous disclosure](http://www.asx.com.au/ListingRules/chapters/Chapter03.pdf) |
| 4 | [Periodic disclosure](http://www.asx.com.au/ListingRules/chapters/Chapter04.pdf) |
| 5 | [Additional reporting on mining and exploration activities](http://www.asx.com.au/ListingRules/chapters/Chapter05.pdf) |
| 6 | [Securities](http://www.asx.com.au/ListingRules/chapters/Chapter06.pdf) |
| 7 | [Changes in capital and new issues](http://www.asx.com.au/ListingRules/chapters/Chapter07.pdf) |
| 8 | [Transfers and registration](http://www.asx.com.au/ListingRules/chapters/Chapter08.pdf) |
| 9 | [Restricted securities](http://www.asx.com.au/ListingRules/chapters/Chapter09.pdf) |
| 10 | [Transactions with persons in a position of influence](http://www.asx.com.au/ListingRules/chapters/Chapter10.pdf) |
| 11 | [Significant transactions](http://www.asx.com.au/ListingRules/chapters/Chapter11.pdf) |
| 12 | [On-going requirements](http://www.asx.com.au/ListingRules/chapters/Chapter12.pdf) |
| 13 | [Additional requirements for trusts](http://www.asx.com.au/ListingRules/chapters/Chapter13.pdf) |
| 14 | [Meetings](http://www.asx.com.au/ListingRules/chapters/Chapter14.pdf) |
| 15 | [Requirements for documents](http://www.asx.com.au/ListingRules/chapters/Chapter15.pdf) |
| 16 | [Fees](http://www.asx.com.au/ListingRules/chapters/Chapter16.pdf) |
| 17 | [Trading halts, suspension, removal](http://www.asx.com.au/ListingRules/chapters/Chapter17.pdf) |
| 18 | [Application of listing rules](http://www.asx.com.au/ListingRules/chapters/Chapter18.pdf) |
| 19 | [Interpretation and definitions](http://www.asx.com.au/ListingRules/chapters/Chapter19.pdf) |
| 20 | [Self-listing of ASX](http://www.asx.com.au/ListingRules/chapters/Chapter20.pdf) |

**1.42 Go to JB Hi-Fi’s website (**[**www.jbhifi.com.au**](http://www.jbhifi.com.au)**) and read the independent auditor’s report in JB Hi-Fi’s latest financial statements.**

1. **What do you think is the purpose of the audit report?**
2. **What are the responsibilities of the directors for the financial statements?**
3. **Why has JB Hi-Fi prepared the financial statements in accordance with IFRSs and Australian regulations such as Australian Accounting Standards?**
4. **What tasks does Deloitte perform in order to prepare the audit report?**
5. The independent audit report’s purpose is to express an opinion on the financial report of JB Hi-Fi. It states that Deloitte have complied with Australian auditing standards when conducting their audit and undertaken procedures to determine that the financial report does give a true and fair view of the operations for the last financial period, does comply with Australian accounting standards, corporations regulations and IFRSs.
6. The directors of the entity make a statement declaring that the financial statements are in compliance with accounting standards and also give a true and fair view of the financial performance and position of the entity.
7. Since 2005, Australian reporting entities have complied with IFRS. Additionally Australian reporting entities must also comply with Australian GAAP, i.e. Australian Accounting Standards (which may be slightly different to the IFRSs).
8. Deloitte will conduct the audit in accordance with Australian auditing standards, in doing so they will also perform procedures to obtain audit evidence about the amounts and disclosures in the financial report. They will also evaluate the appropriateness of accounting policies used by JB Hi-Fi and the accuracy of the estimations made by directors.

**1.43 Refer to the latest financial statements for JB Hi-Fi Ltd (the notes to the 2011 consolidated financial statements of JB Hi-Fi appear in the appendix to this book and the statements are available at www.jbhi.com.au). For each of the following stakeholders, give an illustration of a report or a note that would be useful for decision-making purposes, state why the information is useful, and give an example of how that information would be used.**

**a. JB Hi-Fi Ltd’s shareholders**

**b. Australian banks**

**c. Customers purchasing phones and cameras**

**d. Employees of JB Hi-Fi Ltd.**

**e. Financial analysts**

**f. Deloitte (auditors)**

**g. Australian environmental groups**

a. JB Hi-Fi Ltd’s shareholders – All financial statements, auditor’s report and directors’ report. This information would be useful to help them assess the performance and position of the entity at the end of the financial period and what their future prospects are.

b. Australian banks – Balance Sheet, Statement of Cash Flows and note 19 on borrowings.

This information will allow them to determine the financial structure of the entity and calculate ratios such as liquidity, financial structure. They can also assess the entity’s ability to meet future cash obligations.

c. Customers– Income Statement, notes on income and also notes on provisions such as warranties.

This information can assist in determining the profitability of the business and by looking in the notes, the main sources of income for the business. Product warranty information may provide them with estimates on the percentage of products returned to the entity.

d. Employees of JB Hi-Fi Ltd. – All financial statements, note 2 (v) share based payments to employees.

Employees are going to be interested in future profitability and cash flow. Job security, promotional opportunities will be of interest to employees. They will also seek information on remunerations such as employee share based plans.

e. Financial analysts – All financial statements and segment report – note 31.

Financial analysts are interested in any financial statements providing them with information to help determine future profitability, cash flows and share price. Segment data will allow them to assess the relative risks and returns of the different line of business and geographic segments that the entity operates in.

f. Deloitte (auditors) – All financial statements and accompanying notes on policies.

Auditors need to closely scrutinise the financial statements and the notes on accounting policies to determine what policies the firm has implemented during the period, which accounting standards have been early adopted (if any) and this combined will allow them to assess the accuracy of the amounts disclosed in the financial statements.

g. Australian environmental groups - the environmental statement.

The environmental statement discusses the voluntary initiatives that the entity is involved to minimise the impact of their operations on the Australian and New Zealand environment. Voluntary projects include the carbon disclosure project and the national packaging covenant.

**1.44 Norman is just completing her final year of a commerce degree, majoring in accounting, and she wishes to become a member of a professional accounting association. Access the websites of the four associations, CPA Australia (www.cpaaustralia.com.au), the Institute of Chartered Accountants in Australia (www.icaa.org.au) and the Institute of Public Accountants (**[**www.publicaccountants.org.au**](http://www.nia.org.au)**), and the New Zealand Institute of Chartered Accountants (www.nzica.com).**

**Prepare a one-page memo to Norman advising him on the strategic mission of all of these associations, any prerequisites for becoming a member of each, and the areas and activities that each one is typically involved in.**

Please see the websites above for details relating to the strategic missions, prerequisites and the areas and activities that each of the professional associations are involved with.